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| Function No. 50000—Payroll Accounting | TOPIC | RETIREMENT— SALARY REDUCTION PLANS |
| Section No. 50400—Deductions | DATE | October 2004 |

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Overview

Introduction As an incentive to save for retirement, internal revenue code (IRC) allows employees to defer tax on wages that are invested in certain retirement plans under salary reduction agreements. Two plans are available to Commonwealth employees, §457 (deferred compensation) and §403(b) (tax-sheltered annuity) plans.

Deferred Compensation

Introduction All employees of the Commonwealth including wage employees and elected or appointed officials are eligible to defer a portion of their salary from income taxes through participation in the a tax-deferred investment program administered by the Virginia Retirement System (VRS), called the Virginia Deferred Compensation Plan. The amount deferred is deducted from gross pay prior to computing Federal and State income taxes. Deferred Compensation contributions are transferred to a financial services company (hereafter called the Plan Trustee) for investment. The amounts deferred, plus any accumulated interest, are not taxed until a distribution is made to the participant, usually at retirement. IRC §457 governs state deferred compensation plans.

Contribution Limits A minimum deferral of \$10 per pay period is required to participate in the Deferred Compensation Plan. As of 2004 the annual maximum is the lesser of:

- \$13,000 or
- 100% of includable compensation

The annual maximum will increase by \$1,000 each year through 2006 up to \$15,000. Thereafter, the maximum will be indexed in \$500 increments.

Includable compensation is the annual salary less the annual pre-tax purchase of prior service credit. Other pre-tax deductions, such as, premium conversion, are no longer subtracted from the annual gross salary in determining includable compensation. Deferrals can also be made from eligible leave payouts discussed later in this topic. Refer to the Maximum Contribution Amount Worksheet available on the Plan's website at www.vadcp.com.

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Deferred Compensation, Continued

Catch-Up Provision

Two “catch up” plan options are available to participants to make-up some or all deferrals not made during previous years of eligibility.

- Standard Catch Up
- Age 50+ Catch Up

With the Standard Catch Up provision the participant makes additional contributions to the plan during the last three years before reaching normal retirement age. The additional contribution amount is limited to twice the regular deferral limit for each of the three years before retirement. This provision cannot be used in the calendar year in which the participant reaches retirement age.

The Age 50 + Catch Up provision allows those participants attaining age 50 or over during the calendar year to contribute an amount in addition to their allowable maximum. The chart below outlines the additional contributions allowed.

| Year | Age 50+ Additional Amount |
|-------------|---|
| 2004 | \$3,000 |
| 2005 | \$4,000 |
| 2006 | \$5,000 then indexed in \$500 increments. |

The Age 50+ provision and the Standard Catch Up provision cannot be used in the same calendar year. For more information, visit the VRS website.

New Enrollment Forms

Employees must complete the Participant Enrollment Form and Beneficiary Designation Form to initiate the enrollment process. Completed forms for the standard catch up or new enrollments **must** be submitted directly to the Plan Trustee. To obtain enrollment materials visit the Virginia Defined Contribution Plans website at www.vadcp.com.

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Deferred Compensation, Continued

Changes to Contributions

To expedite time sensitive changes, Payroll Authorization Forms completed for the purpose of changing the amount of contributions to existing Deferred Compensation accounts or to stop contributions to an account should be submitted directly to the payroll office of the employing agency.

Remittance Process

DOA transfers deferred compensation deduction contributions to the Plan Trustee on payday. Upon receipt of participant contributions, the Plan Trustee systematically allocates contributions to the appropriate Plan investment fund based on the participant's pre-defined allocations.

Benefit Coordination

The coordination of contribution limits between 457 and 403 (b) is no longer required.

Leave Payouts

In accordance with VRS policy, contributions to deferred compensation may be made from the following leave payouts:

- annual
- sick
- overtime
- on-call
- disability credits
- compensatory
- recognition

A Payroll Authorization Form electing the amount to be deferred from the leave payout, must be submitted to the agency payroll office while the employee is still an active employee. The form should be submitted no later than the month prior to the month in which the amounts would otherwise be paid or made available to the employee.

Program Administration

Policies and procedures governing the administration of the Virginia Deferred Compensation Plan are located on the VRS web site.

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Tax-Sheltered Annuities

Introduction The Commonwealth of Virginia supports payroll deductions for employees eligible to participate in Tax-sheltered Annuities (TSA). TSAs are pretax products available only to employees in qualifying positions at higher educational institutions or qualifying educational agencies. IRC §403(b) governs tax sheltered annuities. Publication 571 explains the tax rules that apply to a 403(b) plan.

Contributions are administered through a Third Party Administrator (TPA). The TPA is responsible for maintaining a network of participating vendors, notifying agencies of enrollments and related payroll deductions, and distributing payroll deducted contributions to appropriate vendors. Upon receipt of authorization (*change listing report*) from the TPA, agencies must establish the payroll deduction for the employee. Depending on the vendor, an administrative fee may apply that must be charged to the employee through payroll deduction.

Contribution Limits The elective deferral limit is \$13,000 in 2004. The plan limit will increase by \$1,000 each year through 2006 up to \$15,000. Thereafter, the plan limit will be indexed in \$500 increments.

15 Year Rule Plan participants with at least 15 years of service may be eligible to increase the elective deferral limit by up to \$3,000. For more information reference IRS Publication 571, Tax-Sheltered Annuity Plans (403(b)Plans).

Catch-Up Provision Participants who will be age 50 or older during the calendar year may make additional contributions to the plan as outlined below.

| Year | Age 50+ Additional Amount |
|-------------|--|
| 2004 | \$3,000 |
| 2005 | \$4,000 |
| 2006 | \$5,000 then indexed in \$500 increments each year after 2006. |

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Tax-Sheltered Annuities, Continued

Central Remittance Process

Employee contributions are electronically transferred by DOA to the TPA each payday. The TPA then distributes payroll deducted contributions to the appropriate vendor within 3 business days.

MEA Calculation Eliminated

Calculation of the maximum exclusion allowance (MEA) is no longer required in determining the maximum amount contributable (MAC) for 403 (b) account participants.

Administrative Processing Overview

The TPA provides vendors with standard Salary Reduction Agreement (SRA) forms. **The SRA form is the only acceptable form to start, stop or change deductions.**

Generally, SRAs are initiated between the vendor and the employee. In the absence of the SRA from the vendor, the agency must provide the TPA with an SRA. **The TPA requires specific information in order to establish the employee record in the system.**

Prior to the employee completing an SRA with the vendor, the agency benefits administrator is responsible for providing accurate salary and hire date information to the vendor for calculating the MAC (Maximum Amount Contributable). This is performed by completing the Benefits Administrators Approval (BAA) form. Employees submit the BAA form along with the enrollment application to the vendor. The vendor processes the application, calculates the MAC, and submits them to the TPA for review and processing. The TPA notifies agency payroll administrators to establish the annuity and any applicable administrative fee deductions in CIPPS through the Change Listing. The TPA subsequently remits the original SRA forms to the agency for filing.

To ensure that the deductions start on the correct payday, payroll cut-off dates must be strictly enforced. If the cut-off date has not been met, the deduction will start on the next payday. A schedule of cut-off dates is available on DOA's website at http://www.doa.virginia.gov/procedures/Payroll/TPA/TPA_Cutoff_Dates.htm.

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Tax-Sheltered Annuities, Continued

Administrative Fees A fee is required by the TPA to cover costs for administering the program. This fee is paid by some vendors. **For those vendors which do not pay the fee, an administrative fee must be charged to employees.** The employee paid fee is \$.35 per pay period, per provider. For example if an employee has three 403(b) providers the \$.35 fee must be charged for each provider (total \$1.05) each payday. **The administrative fee deduction must be established in CIPPS at the same time the TSA deduction is established.**

TPA Administration For more information on TPA processing, access the TPA Administrative Manual on the DOA website at, <http://www.doa.virginia.gov/procedures/Payroll/tpa/SuppinsPayrollManual.pdf>.

For detailed information regarding network providers and the vendor fee status, visit the TPA website at www.fbmc-benefits.com/VaProviderNetwork/index.asp.

Establishing Deductions

Online Data Entry Access the Employee Deductions screen as instructed in, CAPP Topic No. 50110, *CIPPS Navigation*.

Sna - EXTRA! Personal Client

File Edit View Tools Session Options Help

230,1111112500,036 ON H0ZDC

-----EMPLOYEE DEDUCTIONS-----

COMPANY--> 00230 EMPLOYEE NUMBER--> 1111112500
NAME-----> OSCAR 0 OLSON

| NO | NAME | CALC | GN | FR | PRTY | AMT/PCT | START DATE | GOAL | END DATE | UTILITY | DED MTD | DED YTD |
|----|----------|------|----|----|------|---------|------------|------|------------|------------------|---------|---------|
| 36 | LT DISAB | | | | | .00 | 00/00/0000 | .00 | 00/00/0000 | 0000000000000000 | .00 | .00 |
| 39 | | | | | | 50.00 | 00/00/0000 | .00 | 00/00/0000 | .00 | .00 | .00 |
| 42 | | | | | | .35 | 00/00/0000 | .00 | 00/00/0000 | .00 | .00 | .00 |
| 0 | | | | | | .00 | 00/00/0000 | .00 | 00/00/0000 | .00 | .00 | .00 |

0002H-UTILITY FIELD WILL BE POPULATED 09/08/04 08:33:39 1 M3LL CIDL

14/02

SNA Server: Connected T1 NUM 8:32 AM

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Establishing Deductions, Continued

No
(Required)

Enter applicable deduction number:

| If... | Then... |
|--------------|------------------------|
| 038 | Deferred Compensation |
| 039 | TSA |
| 042 | TSA Administrative Fee |

NAME

Do not enter. The system will display the corresponding deduction name after the information is entered into the system.

CALC

Do not enter. This field indicates the type of calculation to be performed. This field is displayed by the system.

AMT/PCT
(Required)

Enter the dollar amount, to two decimal places, to be withheld each pay period.

GOAL

| IF | THEN |
|-----------|---|
| Ded. 038 | Enter the total annual contribution amount. |
| Ded. 039 | Enter the total annual contribution amount. |
| Ded. 042 | Do not enter. |

UTILITY

| If... | Then... |
|-----------------------------|--|
| Ded. 038 and Ded. 039 | No data entry is required. This field is automatically populated with the appropriate setup '000000000022000000' when establishing pre-tax deductions. |
| Ded. 042 | Do not enter. |

CALC/GN

Do not enter.

FR

Enter the appropriate frequency for the deduction. Usually '09'.

PRTY

Do not enter.

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Establishing Deductions, Continued

Online Data Entry (continued)

START DATE Enter the beginning date for the deduction. Enter as
(**OPTIONAL**) MM/DD/YYYY. The deduction will begin during the first payroll period when the date is less than the CTL period end date.

END DATE Enter the cut-off date for this deduction. Enter as MM/DD/YYYY.
(**OPTIONAL**) The deduction will end during the payroll period when the date is less than the CTL period begin date.

DED MTD Do not enter.

DED YTD Do not enter.

Internal Control

Internal Control

Agencies must ensure proper documentation exists prior to initiating any change to an employee masterfile and that changes are made accurately and timely. Additionally, agencies should use reports 855 and/or 857 (Deferred Compensation/Annuity Excess Deduction Reports) to assist in identifying employees who may be approaching or exceeding plan contribution limits.

Records Retention

Time Period

All payroll related documents and records should be retained for a period of 5 years or until audited whichever is later.

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Contacts

DOA Contact Manager, State Payroll Operations
Voice: (804) 225-2245
E-mail: Payroll@doa.virginia.gov

State Payroll/Training Analyst
Voice: (804) 225-3120 or (804) 225-3079
E-mail: Payroll@doa.virginia.gov

Subject Cross References

References CAPP Topic No. 50110, *CIPPS Navigation*
